

COMMONWEALTH OF MASSACHUSETTS
DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

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Standard Offer Service) D.T.E. 00-66, 00-67, 00-70

Fuel Adjustment)

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**COMMENTS OF THE MASSACHUSETTS DIVISION OF ENERGY
RESOURCES**
ON PROPOSED ADJUSTMENTS TO STANDARD OFFER SERVICE RATES

Introduction

The NSTAR Companies (Boston Edison Company, Cambridge Electric Light Company and Commonwealth Electric Company) (collectively, "NSTAR"), Massachusetts and Nantucket Electric Companies ("MECo"), and Fitchburg Gas & Electric Light Company ("Fitchburg") have proposed increases in their respective rates for Standard Offer Service ("SOS"). ⁽¹⁾ Such increases are being proposed to recover from retail SOS customers fuel costs charged to the distribution companies by their wholesale suppliers of SOS. The Division of Energy Resources ("DOER") appreciates having this opportunity to provide the Department of Telecommunications and Energy ("Department" or "DTE") with comments on the companies' proposals.

DOER acknowledges that oil and natural gas prices have spiked and are likely to remain quite high in the short-run. DOER also does not question the companies' claim that they have been accruing large deferrals, and will add materially to those deferrals if retail prices are not increased to mirror wholesale costs of SOS including fuel index adjustments. However, DOER objects to two aspects of the

companies' proposals as set forth below. These comments focus, in particular, on the proposals submitted with respect to Boston Edison Company ("BECO") and MECO.

The Inflation Cap Calculation Should Not Include the Fuel Index Adjustments

DOER is not disputing the right of MECO and BECO to recover payments made to wholesale suppliers of SOS for extraordinary fuel expenses under the various wholesale contract fuel price indices now in effect. We agree with both MECO and BECO that their respective Restructuring Settlement Agreements ("RSA") guaranteed recovery of such payments to wholesale SOS suppliers for fuel index-related costs. We also agree with MECO and BECO that their respective RSAs were found to be in substantial compliance with the Electric Utility Restructuring Act of 1977 (the "Act"). Therefore, DOER sees no procedural or legal bar to recovery of those costs. However, as a party to both of those RSAs, DOER does not agree with MECO and BECO's legal theory that the inflation cap calculation should include extraordinary increases in fuel costs. We agree that G.L. c. 164, § 1B(e) provides the Department with substantial discretion in determining how to calculate the inflation cap. However, the Department has already determined that the Consumer Price Index is the appropriate measure of inflation for purposes of implementing the inflation cap. Fuel costs constitute only about 3 percent of the total costs accounted for under the CPI. It would be inappropriate to change the inflation index merely because fuel costs have risen at a rate greater than the CPI. DOER believes it would be chaotic to start down the path, suggested by MECO, of adding extraordinary fuel costs into the inflation calculation now and taking them out "when fuel costs later moderate." D.T.E. 00-67, Letter of Mr. Gerwatowski, September 1, 2000 at 2. Fuel prices may "moderate" one month, soar the next, and drop substantially thereafter. Fuel markets are not orderly or predictable; prices do not ebb and flow within tidy time periods corresponding to regulatory decision dates. In DOER's view, there is no need to complicate the calculation of the inflation cap by continuously adding or subtracting fuel price changes other than in the manner already accounted for under the CPI.

DOER's approach of keeping the CPI as the measure of inflation is, in fact, more consistent with the terms of BECO's and MECO's RSAs. For example, as noted in the Direct Testimony of Mr. Zschokke for MECO,

Section I.B.(9) of the Company's Restructuring Settlement uses the Consumer Price Index ("CPI") as the measure of inflation, but specifically permits the effects of extraordinary inflation in fuel costs to be taken into account in determining whether the inflation-based rate cap has been exceeded. This is accomplished by excluding the fuel index payments from the calculation.

Direct Testimony at page 14 (emphasis supplied). Mr. Zschokke is correct -- the fuel index payments are to be excluded from the rate cap calculation. That approach is the same as that in the BECO RSA. Section I.B.9, captioned "Inflation Cap for Standard Offer Customers," expressly provides that the calculation of the rate reduction must be adjusted to "exclude the effect of: (1) the fuel price index in Attachment 4...." Simply stated, both the MECO and BECO RSAs exclude from the rate cap calculation extraordinary fuel costs for SOS.

The exclusion of those costs from the rate cap calculation is entirely consistent with G.L. c. 164, § 1B(e) which requires that the "economic value of the rate reduction under this section, be maintained during the standard service transition period." The 15 percent reduction is relative to rates in effect in August of 1997. Those rates were subject to adjustment for utilities' fuel costs. If fuel costs rose, consumers bore those costs, subject to DTE review and approval. Similarly, under the SOS tariffs, extraordinary fuel costs under wholesale contracts may be recovered. Therefore, "the economic value of the rate reduction" remains intact today, notwithstanding a

distribution company's recovery of extraordinary wholesale fuel adjustments under the approved contractual indices. There is no need to warp or distort the measure of inflation used by the DTE to accommodate extraordinary fuel costs under the rate reduction cap. Those costs can and should be excluded from that calculation, and do not threaten or compromise in any way the economic value of the 15 percent rate reduction.[\(2\)](#)

Fixed Rate Approach Is Preferable to Variable Rate Approach

Although BECo's proposal to allow SOS rates to vary monthly with the latest fuel cost calculation is appealing from a number of perspectives, DOER believes it will cause customer confusion and aggravation in a period where rates are temporarily high and the competitive market has not yet responded adequately. Moreover, because of the use of six- and twelve-month rolling averages in the various fuel indices, monthly adjustments would not achieve BECo's stated goal of having retail prices actually track wholesale prices. At the present time, DOER believes MECo's proposal for a fixed rate is preferable.

High SOS Fuel Tariffs and Surcharges Should Heighten

Scrutiny of Companies' Transition Cost Mitigation Efforts

The RSAs and the Act allocated restructuring risks between customers and utilities. By the terms of the RSAs, customers accepted fuel price risk. In exchange, utilities took on the responsibility of minimizing Transition Costs to the maximum extent possible. As a result of high fuel prices in the short run, customers will be paying more for electricity than perhaps was anticipated. Distribution companies can lessen the burden of high fuel prices by diligently pursuing their obligation to minimize Transition Costs. In the upcoming Transition Cost Reconciliation proceedings, MECo, BECo and the other companies should expect a high degree of scrutiny with respect to their mitigation efforts. To the extent that companies failed to properly mitigate Transition Costs or other costs, they should expect to forfeit recovery of such costs. For example, as part of its RSA, BECo committed itself to a plan to divest itself of its Power Purchase Agreements ("PPAs") as a means of mitigating stranded costs. G.L. c. 164, § 1G(d)(2)(i) requires that beginning July 1, 1998, the Department review "at least annually" the status of each distribution company's efforts to renegotiate or buy-out any above-market PPAs. Although BECo filed reports with the DTE in 1998 and 1999, it is DOER's understanding that the DTE did not issue any findings in 1999 on BECo's efforts nor has BECo filed an update with the Department for this year. If this is the case, DOER believes that this is not the level of diligence which the Restructuring Act envisioned in requiring that Transition Cost mitigation be pursued to the maximum extent possible. BECo has not demonstrated in this docket or elsewhere that it has minimized Transition Costs associated with its PPAs. Therefore, BECo should anticipate that those costs and others will be closely scrutinized in the upcoming Reconciliation proceeding.

Respectfully submitted,

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1. 1 The companies are proposing either new tariffs or new surcharges on existing rates.

2. 2 DOER's position that fuel costs are by law to be excluded from the calculation of the 15 percent rate cap should not be interpreted as implying that distribution companies whose tariffs meet the 15 percent discount level are exempt from the obligation to minimize Transition Costs and minimize all other cost components of customers' bills. The supervisory authority of the DTE over distribution companies allows the DTE to investigate and scrutinize any possible lost opportunities to achieve savings on behalf of customers even where a distribution company's tariffs are at or below the 15 percent discount level.